

To: Dr. John Yinger

From: Callie Dick and Tessa Sontheimer

Subject: Cannabis for College: A Plan for Using Revenues from the Legalization of Recreational Cannabis to Revitalize Pennsylvania State University System of Higher Education

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Executive Summary

The Pennsylvania State University System of Higher Education (PASSHE) is a network of state-supported public universities. Since the early 2010s, PASSHE has undergone large decreases in funding and has had to increase tuition costs to manage budget shortfalls, which in turn has led to declines in attendance. Legalizing recreational cannabis usage and sale is a unique opportunity in the state of Pennsylvania for tax design innovation and to create a new revenue stream through earmarking funding towards education. Legalization and taxation of marijuana would also allow Pennsylvania to capture the externalities of marijuana use and limit tax leakage. This would allow Pennsylvania to supplement the public higher education system budget deficits. The revenues raised via the new tax scheme will be earmarked for the university system. This pairing will increase the political feasibility of marijuana legalization legislation and strengthen the financial future of Pennsylvania's State System of Higher Education (PASSHE).

Background

Established in July 1983, the 14 universities of PASSHE work to promote educational attainment across the Commonwealth and beyond. There are more than 93,000 degree-seeking undergraduate and graduate students in 2,300 degree and certificate programs (“About the State System”). The largest campus is the West Chester campus with 17,500 students and the smallest is the neighboring Cheyney campus with 460 students. Notably, Cheyney is the first Historically Black College in the United States.

According to Act 188 of 1982, the mission of PASSHE “is the provision of instruction for undergraduate and graduate students to and beyond the master’s degree in the liberal arts and sciences, and in the applied fields, including the teaching profession” (“The State System’s Economic and Employment Impact”, pg. 2). PASSHE is the 18th largest employer in the state and has a physical presence in 20 of the 67 counties in Pennsylvania. Using a Regional Input-Output Modeling System, a 2015 report of the 2013-2014 fiscal year found that the “estimated combined economic and employment contribution of PASSHE on the Commonwealth was approximately \$6.7 billion” (“The State System’s Economic and Employment Impact”, pg. 4). The same report found the total direct impact of PASSHE was \$2.92 billion, the total indirect impact was \$1.27 billion, and the total induced impact was \$185.78 million with a total economic impact of \$4.38 billion. Direct impact is defined as actual expenditures including capital. Indirect impact is “the changes in sales, income, or jobs in sectors within the region that supply goods and services to a specific sector” and induced impact is “the increased sales within the region from household spending of the income earned in a specific supporting sector” (“The

State System's Economic and Employment Impact", pg. 4). These findings demonstrate that the presence of PASSHE is vital to the state as its presence has made a sizable difference in Pennsylvania's economic health and employment creation. Over the last decade, the decrease in attendance has led to decrease in demand for employment of faculty and staff positions all over the state. Attendance decreases contrast 2016 projections from the Georgetown University Center on Education and Workforce that found that by 2020 more than 60% of jobs in Pennsylvania will require at least some postsecondary education, with more than one-third of those from 2010 to 2020 requiring a bachelor's degree or higher (Carnevale, Lou, Ridely, 2016, pg. 5).

PASSHE is currently undergoing a multi-year, multi-phase redesign that began in 2017. The three-phase process involved establishing "strategic priorities" from July 2017 to January 2019; defining the PASSHE's vision and a plan to reach that goal from January 2019 to January 2020; and acting on those plans from January 2020 to present to promote continual improvement of the system ("System Redesign Phases"). Priorities of the PASSHE redesign include "ensuring student success, leveraging university strengths, and transforming the governance and leadership structure" ("System Redesign Phases"). An infusion of revenues would fit into transforming the governance structure and ensure the long-term financial stability. However well-intentioned the system redesign may seem; we have various concerns regarding how vague and unreported the changes made by the redesign have been. The system redesign framework frequently mentions financial and metric transparency as well as the plan for the redesign, yet there are no metrics to be found and no more detail as to what the "plan" for what post redesign PASSHE actually is. There is also little discussion on how the COVID-19 pandemic has impacted the redesign. This is striking given that PASSHE saw decreases in enrollment around 2.6% in the fall 2020 semester and lost over \$300 million due to COVID-19, mostly through lost room and board financing (Finnerty, 2021).

The redesign of PASSHE is in direct response to the change in administration between former Governor Tom Corbett (R) and current Governor Tom Wolf (D). During his time in office, Governor Corbett cut public education funding by around \$1 billion dollars in order to balance the state budget. He initially proposed a budget cut of 20%, however the bill passed with an 18% cut instead. The decrease in funding from the state resulted in an increase in tuition fees for students, which in turn affected the rate of attendance for these colleges. Although the PASSHE budget appears to be visible on their website, it is accessible only with a password so there is no public documentation of how the budget cuts led to a redistribution of funding in the following years. The Office of the Governor, via *PR Newswire*, gave a press release on March 8, 2011, attempting to explain the extensive budget shortfalls. However, instead of helping Pennsylvania citizens understand the budget issues, the press release sent shocks through the state and many low-income families began to fear that their children would no longer be able to attend college due to increases in tuition cost (Wise, 2020). The cycle of decreasing funding, increasing cost for students, and a downturn in attendance has continued to harm the public university system. By

decreasing funding for PASSHE in order to solve state budget deficits, Former Governor Corbett set off a ripple effect that has had a damaging impact on the viability of and caused a decrease in the university education budget in Pennsylvania (Esack, 2014). According to *Inside Higher Ed*, after “feeling the burn of budget cuts...the universities have shed 5 percent of their permanent work force and discontinued or frozen new enrollment to 198 academic programs” which was reported only one year after the aforementioned budget cuts. Additionally, 45 tenure and tenure-track faculty positions faced retrenchment (Rivard, 2013). The state has since seen a significant drop in attendance and no reconciliation of the budget.

Current Status: Pennsylvania Education

Out of the 14 public universities within Pennsylvania's State System of Higher Education (PASSHE), all of them, except for the West Chester campus, have experienced a decline in attendance over the past 10 years (Fernandez, 2019). Overall, there has been a statewide decline in attendance of around 20% in the last decade. According to the Association of Pennsylvania State Colleges and University Faculties (APSCUF), the increase in tuition cost is directly related to the budget reduction passed by Governor Corbett. The resulting tuition increase was projected to have harmed many low-income families or those who were on the cusp of not being able to afford attending university. It is speculated by the APSCUF that in direct response to the tuition increase, the attendance has decreased. As the number of students attending has decreased, the cost of tuition for students has increased which has grown to a statewide problem of lower college attendance rates and has no sign to slow down any time soon. Based on the consistent decline in student numbers at state universities, PASSHE has reached record lows that have not been seen since 2001 (Hoover, 2019).

The costs for students vary across the PASSHE system. At Cheyney, the smallest institution in the system, a full-time undergraduate PA resident enrolled in the 2020-2021 school year would pay \$10,904 for 12-18 credits each semester; a non-PA resident in the same time period at the same enrollment level would pay \$18,870 (“Undergraduate Tuition Costs”). At West Chester, the largest institution in the system, a full-time undergraduate PA resident enrolled in the 2020-2021 school year with room and meals would pay \$19,371 for 12-18 credits each semester; a non-PA resident in the same time period at the same enrollment and housing level would pay \$31,195 (“Cost Calculator”).

Current Status: Neighboring States

The decrease in population in Pennsylvania has occurred at comparable rates between its neighbors, New York and New Jersey. The trends in overall population growth among these three states is comparable with a steady and similar pattern of slight decrease in the last five years, with noted and practically equivalent population decreases after the 2008 recession (Macro Trends). However, when comparing public university attendance information for the New York public university system State University of New York System (SUNY), the decline in attendance over the last decade has only been 5.1% compared to PASSHE’s decline of 20%

(SUNY, Fast Facts). Despite the SUNY system being significantly larger than the PASSHE system, with around 400,000 students compared to PASSHE's 100,000, the differences in declining attendance rates are significant. New York State officials often attribute the 5.1% decline in attendance to general population decreases, however PASSHE's decrease which is four times that of SUNY's, is more difficult to explain with that justification.

Current Status: Cannabis Legalization

Recreational and medical marijuana is currently illegal at the federal level. Marijuana is a Schedule I drug under the Controlled Substances Act of 1973. Currently 17 states and the District of Columbia have legalized and taxed marijuana. In 2020, prior to the COVID-19 pandemic, the industry was expected to generate over \$1.8 billion dollars in tax revenue (Boesen, 2020). The 2013 "Cole Memo" from the Department of Justice provided states with "prosecutorial discretion" for enforcement of federal marijuana laws, opening the door for state law to differ from federal regulations (Cole, 2013). As of 2017, recreational marijuana was a \$9 billion industry (Mace, Patel, Seegert, 2020).

Recreational use of cannabis is not legal in Pennsylvania, however medical marijuana sale and use has been legal since 2016. There are multiple states bordering PA that have legalized medical marijuana within the last five years or are on track to full recreational legalization, the most recent being New Jersey and New York. A 2019 survey from the Center for Behavioral Health and Statistics Quality, found that 8.66% of Pennsylvanians, or around 862,000 people had used marijuana products in the last 30 days despite its current illegal status (Boesen, 2020). Given the potential bias for people to not report using cannabis, this figure is potentially much higher. There is speculation that Pennsylvania residents may drive to states where cannabis is legal in order to purchase it and bring it back illegally, however it is difficult to find data regarding how frequent this happens. Across the state, the repercussions of being caught with cannabis illegally differ based upon location (Wise, 2020). In some areas, someone caught with cannabis might receive a small fine, while in other areas where a large fine, misdemeanor charge and potential jail time is more likely.

The current political environment in Pennsylvania, with a Democratic governor and Republican controlled legislature is likely the most significant barrier to legalization. There is evidence that the political conversation around marijuana may be shifting. The current bill, Adult Use Cannabis and Economic Recovery bill, which was introduced in February 2021 would legalize cannabis for adults 21 and older. For the first time a piece of legislation for marijuana legalization has a Republican co-sponsor, Sen. Dan Laughlin of Erie County. This bill would allow medical users to grow up to five plants in their home and expunge the records of any Pennsylvanian accused of a non-violent marijuana offense (Rink, 2021).

During a listening tour, Lt. Governor of Pennsylvania John Fetterman in 2019 visited all 67 Pennsylvania counties and held town halls and listening sessions on the topic of recreational

marijuana legalization. He had 70 stops over 98 days to speak to Pennsylvanians about the future of marijuana legislation in the state. His report states that 65-70% of Pennsylvanians support the legalization of adult-use marijuana. Other key findings are that Pennsylvanians want an oversight entity created to “regulate sales in a strict, controlled manner”, residents support “decriminalization and mass expungement of non-violent and small cannabis-related offenses”, and that the economic impact of legalization is clear to Pennsylvanians. Fetterman reports that the economic potential includes saving “money on prosecution and incarceration of cannabis-related offenses” and creation of jobs through new businesses. Residents stated that revenues generated “should be used for infrastructure, education, and property tax relief” (“Lieutenant Governor Fetterman Statewide Cannabis Listening Tour Report”, 2019).

Why Legalization is Vital

It is important to legalize and tax marijuana for a range of public health and economic reasons. The government cannot control the externalities and internalities and raise revenues via a tax without first legalizing marijuana.

Internalities are the harms that consumers inflict upon themselves; effectively taxing these increases overall economic efficiency (Marron, 2015). Examples of externalities of cannabis include the smell, increased risk of driving under the influence, and pollution from green houses. An example of an externality is the increased lung cancer risk. Taxing the externalities of marijuana is paternalistic but helps increase economic efficiency as a tax is more efficient if it “reflects any harms consumers overlook, whether to others or themselves” (Marron, 2015, pg. 1). Taxing internalities introduces concerns about distributional effects as individuals with lower incomes are more likely to overlook future costs (Marron, 2015). The paternalistic nature of cannabis taxation would mimic other sin tax interventions.

Other important justifications for legalizing and taxing marijuana include to 1) “reflect external, or spillover, costs to society; 2) discourage use, particularly for youth; 3) prevent too rapid a fall in price; 4) fund related programs; 5) and raise revenues” (Congressional Research Service, 3, 2014). We agree with the justification presented by the CRS and support the legalization of recreational cannabis for these reasons.

Proposition for Legalization

In 2020, New Jersey legalized and began to tax marijuana with a statewide referendum. In 2021, New York followed New Jersey’s lead and legalized recreational cannabis Legislation (S.854-A/A.1248-A). The full title of the New York State bill is “Establishes the Office of Cannabis Management; Expands New York's Existing Medical Marijuana Program; Establishes a Licensing System; and Creates a Social and Economic Equity Program Encouraging Individuals Disproportionately Impacted by Cannabis Enforcement to Participate in Industry” (“Governor Cuomo Signs Legislation Legalizing Adult-Use Cannabis”). Some scholars point to New Jersey’s legalization as a “lynchpin” to flipping the Northeast’s marijuana policies (Garber-Paul,

2020). Frequency of recreational marijuana legalization has increased as more information regarding the health impacts of cannabis emerges in the medical literature. According to the Pew Research Center, many believe that alcohol and cigarettes are just as if not more dangerous, and that cannabis is not as detrimental as other drugs. Information regarding marijuana's health benefits continue to spread within the medical community. The American College of Physicians attributes the gap in the research literature to its classification as Schedule I drug and the limitations placed on its use in research settings at the federal level. (Congressional Research Service, 12, 2014). Legalization of recreational marijuana at the federal level is most likely inevitable for the United States. While there is no firm timeline on when it will happen but until it is federally legalized, states have the opportunity to capitalize on early entry into the legal market. Pennsylvania should take this opportunity to legalize as cannabis use becomes more favorable to bring money into the state directly and address budget shortfalls for PASSHE.

Our proposal recommends legalizing marijuana with *ad valorem* or percent of price scheme similar to Colorado. Our choice to mirror Colorado's approach is guided by the fact that they have had legal recreational cannabis since 2014, have undergone multiple iterations of rate and design, and it is considered "the best resource for "long-term" lessons" at the state-level (Boesen, 2020, pg. 11).

Our approach would include an ad valorem tax administered at two different points in the supply chain. First, there would be a 15% excise tax, "levied at wholesale by weight at average market rate" and a 15% excise tax on the retail price, including sales taxes in the tax base (Boesen, 2020). Setting the rate at 15% would be directly taken from the foundation set by Colorado. Our tax rate will increase 2.5% each year for the first five years. While the goal of the tax would be to appropriately capture the internalities and externalities associated with cannabis consumption and production, the revenues raised can be used to fund valuable programs (Marron, 2015). This tax design is advantageous as it captures lessons from Colorado and appropriately tailors our tax rate to address the prohibition premium. The prohibition premium is the rapid decrease in price which occurs after legalization due to the expansion of the legal market and its change in legal status. The price drop increases the ease at which consumers can abuse marijuana and makes it more difficult to reflect the negative externalities and internalities so Pennsylvania's tax will increase over time to minimize this (Oglesby, 2017).

Based upon the annual excise tax revenue from Colorado receipts for fiscal year 2019 approximated to Pennsylvania, a similar tax scheme is expected to raise \$279 million dollars per year (Boesen, 2020). A more conservative measure for the first fiscal year after legalization approximates revenues of \$103 million dollars, without counting general sales taxes, fees, and other business fees like licenses (Boesen, 2020).

Argument for Earmarking Specifically for Education

Earmarking is a process by which a state designates “some or all of the collections from a specific tax or revenue source for a specific expenditure, with the intent that the designation will continue into the future” (NCSL, 2008). As of 2008, all states use earmarking as a tool and on average 25% of a states’ taxes are earmarked. In 2008, Rhode Island designated 4.4% of its taxes and Alabama earmarked 84% of its taxes (NCSL, 2008).

Earmarking is a valuable tool in the legalization and taxation of marijuana because it guarantees the recipients of the funds, provides clarity around who benefits from a tax, and increases the political feasibility. A number of states that have legalized currently designate their revenues for education. Illinois designates 2% of revenues to public education. In Colorado, funds go to the Department of Education and \$40 million is allocated to public school construction. Vermont allocates all its revenues to education (Boesen, 2020). Designating the source of the marijuana tax revenue increases the political feasibility of the tax. A 2019 Gallup poll found that people aged 18-29 (college aged) are more likely to use marijuana (22%) than older generations which means that they would most likely be bearing the tax burden (Hrynowski, 2020). This supports earmarking for PASSHE as they will contribute to the revenues and receive benefits from its earmarking as near college aged individuals.

Tax Design Considerations

Political feasibility will be the central question for any cannabis tax in Pennsylvania, given the divided government. At present, the Governorship is held by a democrat, while Republicans control the general assembly (“PA General Assembly”). We have seen a shift with some Republican representatives backing or displaying intrigue in legalizing recreational cannabis which is indicative of a shifting dichotomy of support.

Horizontal equity and the tax’s distributive impacts are a concern of policymakers, especially when creating an excise tax as they are likely regressive (Congressional Research Service, 2014). Additional equity concerns arise when taxing internalities as the likelihood to overlook a future cost is associated with having a lower income (Marron, 2015). Concentrated use by certain users also shapes the horizontal equity of a sin tax. In Colorado, it was found that more than 70% of recreational cannabis was consumed by people using it more than 26 days per month (Boesen, 2020). Concentrated groups will bear a large share of the tax incidence, increasing tax regressivity (Boesen, 2020). Additional considerations include tax stability and the administrative potential of the tax. Creating licensing processes and standards can be complicated and costly (Oglesby, 2017). Revenue projections are particularly volatile and administrative costs high at the start of the new tax. Despite these concerns, legalization of recreational cannabis is a strategic move for Pennsylvania as the current illegal status does not integrate any considerations of health impacts and fails to capture a potential revenue stream.

It is important that policymakers in Pennsylvania act quickly to ensure they benefit from cannabis related revenues and limit the strength of the cannabis industry in formulating regulations. Testing and industry standards are lacking and are crucial to ensure the stability and enforceability of a tax (Boesen, 2020). Tax arbitrage is an increasing risk, and we can expect to see more marijuana tourism to neighboring states that have legalized. There is also a potential race to the bottom in terms of tax rates. To attract marijuana producers and sellers from other places, policymakers are incentivized to decrease tax rates within their jurisdiction. If jurisdictions and states don't establish tax rates sensitive to those of their neighbors, producers will be incentivized to relocate to low or no tax areas (Oglesby, 2018).

Tax competition is currently defined by marijuana's illegality at the federal level. This means that in states that have legalized marijuana, only marijuana grown in that state is legal. This set up stymies and essentially eliminates the potential for interstate trading (Oglesby, P, 2018). Tax competition is particularly important for producers, so we are advocating for only a 15% wholesale tax on the weight of marijuana for wholesalers. This builds upon Colorado's approach, has been in practice for seven years, and is one of the most studied state-level tax schemes.

Considerations of excess burden and price elasticity of demand are also very important when considering marijuana legalization and taxation. While the price elasticity of recreational marijuana is debated, a tax on retail price would likely create a relatively small distortion in the economy. Davis et al. estimate the price elasticity for recreational marijuana is between -0.67 and -0.79 (2015). Legalizing marijuana will decrease the price, which generates consumer surplus. In turn, the amount of consumer surplus is decreased by the wedge the tax creates, driving up the price.

As Dadayan acknowledges in *The National Tax Journal*, there is limited and uncertain revenue raising potential for some sin taxes (2019). Additionally, their creation can introduce pervasive incentives for governments (i.e., profiting off of citizens' drug usage). We recognize this as a drawback of this approach, but the benefits are two-fold: generate needed revenues for PASSHE while doing concurrent redesign and better regulating the consumption and usage of marijuana. We disagree with Dadayan's assessment "that longer-term growth patterns for sin tax revenue have often been weak and limited, absent policy changes such as increased tax rates" (2019). Revenue projections for states like Colorado, whose taxation system we would emulate, are substantial amounts, just not necessarily as a percentage of own-source revenues. Additionally, they have been in place for over seven years and have positively impacted the Colorado economy (Boesen, 2020).

Reorganization Recommendations for the State University System

Building upon the structural redesign plan currently in place for the Pennsylvania University System, we recommend increasing the time horizon of financial sustainability plans from five to ten years, increasing funding for student recruitment and retention, and creating a plan to

aggressively repay the bonds currently held by the PASSHE. These recommendations are based on the foundation of affordable and transparent education for the residents of Pennsylvania. Extending the sustainability plans from five to ten years would create a better foundation for the future of the university and increase the time frame of decision makers. This would make the university more versatile and better prepared. Finally, keeping on track to repay the bonds currently held by PASSHE would aid in the stability of the future of the system by maintaining a clean and financially viable system. As of March 2021, Fitch assigned an A+ rating to Pennsylvania Higher Educational Facilities Authority's bonds issued on behalf of Pennsylvania's State System of Higher Education (PASSHE). Currently, the value of the bonds stands at \$830,000,000 taxable revenue bonds (Fitch, 2021).

We support the plan detailed in the February 2020 memo “System Financial Sustainability Guidelines” to consolidate campuses, work to give first priority to current employees from under-utilized campuses to new positions and establish a non-partisan external financial review board. In our view, these are all measured and reasonable steps for PASSHE to take. Our ability to make more specific consolidation and organizational recommendations is impacted by not having access to complete budget information for PASSHE.

Conclusion

Pennsylvania should legalize marijuana to capture potentially lost state-own revenues gained by neighboring states that have recently legalized and started to tax marijuana sales and production. Funds raised by cannabis taxation can be used to refinance the Pennsylvania State Public University System of Higher Education (in a model similar to Colorado and Nevada) to counteract budget reductions within the last decade and decreases in enrollment. Through legalizing recreational cannabis, Pennsylvania will be able to revitalize PASSHE to support an on-going commitment to affordable and high-quality public higher education in the Commonwealth.

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